NOTES

WASHINGTON NOTES

THE INCOME TAX DECISION

The Supreme Court of the United States has handed down (January 24, No. 140, October term, 1915), in the case of *Brushaber* v. *Union Pacific R.R. Co.*, the general opinion regarding the constitutionality of the income-tax section of the tariff act of 1913 which has been anxiously awaited for some time past. The issue primarily dealt with is the validity of the Sixteenth Amendment to the Constitution of the United States, wherein provision was made for the imposition and collection of a tax on incomes. The constitutionality of the amendment is now definitely and conclusively upheld.

The Court first proceeds to classify and summarize the chief objections to the constitutionality of the Amendment as follows:

(*a*) The amendment authorizes only a particular character of direct tax without apportionment, and, therefore, if a tax is levied under its assumed authority which does not partake of the characteristics exacted by the amendment, it is outside of the amendment and is void as a direct tax in the general constitutional sense because not apportioned. (*b*) As the amendment authorizes a tax only upon incomes "from whatever source derived," the exclusion from taxation of some incomes of designated persons and classes is not authorized and hence the constitutionality of the law must be tested by the general provisions of the Constitution as to taxation, and thus again the tax is void for want of apportionment. (*c*) As the right to tax "incomes from whatever source derived" for which the amendment provides must be considered as exacting intrinsic uniformity, therefore no tax comes under the authority of the amendment not conforming to such standard, and hence all the provisions of the assailed statute must once more be tested solely under the general and pre-existing provisions of the Constitution, causing the statute again to be void in the absence of apportionment. (*d*) As the power conferred by the amendment is new and prospective, the attempt in the statute to make its provisions retroactively apply is void because, so far as the retroactive period is concerned, it is governed by the pre-existing constitutional requirement as to apportionment.

The argument of the Court based on this summary leads to the view that the contentions thus cited, if acceded to, would cause one provision of

the Constitution to destroy another; that is, they would result in bringing the provisions of the amendment exempting a direct tax from apportionment into irreconcilable conflict with the general requirement that all direct taxes be apportioned. Moreover, the tax authorized by the amendment, being direct, would not come under the rule of uniformity applicable under the Constitution to other direct taxes, and thus it would come to pass that the result of the amendment would be to authorize a particular direct tax not subject either to apportionment or to the rule of geographical uniformity, thus giving power to impose a different tax in one state or states than was levied in another state or states. This result instead of simplifying the situation and making clear the limitations on the taxing power, a purpose which the amendment must have been intended to accomplish, would create radical and destructive changes in our constitutional system and would multiply confusion.

Dealing directly with the Sixteenth Amendment itself, the Court holds that the language makes it clear on its face that the amendment does not purport to confer power to levy income taxes in a generic sense—an authority already possessed and never questioned—or to limit and distinguish between one kind of income taxes and another, but that the whole purpose of the amendment was to relieve all income taxes, when imposed, from apportionment or from a consideration of the source whence the income was derived. Finally it holds that the purpose of the amendment was not to change the existing interpretation of the term "direct tax," except to the extent necessary to accomplish the result intended—that is, the prevention of any resort to the sources from which a taxed income is derived in order to cause such a direct tax on income to be held a direct tax on the source itself and thereby to take an income tax out of the class of excises, duties, and imposts and place it in the class of direct taxes.

One of the most interesting features of the decision is found in the conclusion arrived at with regard to the progressive feature of the tax. The Court says on this point:

> It is true that it is elaborately insisted that although there be no express constitutional provision prohibiting it, the progressive feature of the tax causes it to transcend the conception of all taxation and to be a mere arbitrary abuse of power which must be treated as wanting in due process. But the proposition disregards the fact that in the very early history of the government a progressive tax was imposed by Congress and that such authority was exerted in some if not all of the various income taxes enacted prior to 1894 to which we have previously adverted. . . . . In this situation it is, of course, superfluous to say

that arguments as to the expediency of levying such taxes or of the economic mistake or wrong involved in their imposition are beyond judicial cognizance.

SECOND REPORT OF THE FEDERAL RESERVE BOARD

The Federal Reserve Board has issued (on February 25) its second annual report (*Second Annual Report Federal Reserve Board*, Washington, 1916). This report covers the operations of the year 1915 and consists of two parts: the first a report by the Board itself, concerning general financial and banking conditions and the scope and character of its own operations; the second consisting of reports furnished by the chairmen of the boards of directors of the several federal reserve banks. There are thus thirteen distinct reports included within the volume—one for each of the twelve federal reserve districts, and the Board's general report in addition. It is safe to say that the document, as a whole, includes a more thorough and detailed review of banking conditions throughout the country during a given year than has ever before been published. Taken in conjunction with the report of the Comptroller of the Currency, it affords an unusually complete and competent survey of banking developments, conditions, and problems for the future.

Among general financial conditions, the remarkable ease of money during the past year is described by the Board as constituting the outstanding feature of the year's operations. Owing to this extreme ease of money and superabundance of reserves, interest rates have been abnormally low, while the lending power of the various national and state banks throughout the country has been unusually strong and high. The consequence has been abundance and freedom of accommodation to all applicants presenting satisfactory security, and practically universal ability to meet any ordinary or recognized demands that might be brought to bear upon the banks.

On the other hand, this great ease of money and the resultant lowness of interest are represented as having kept banking earnings in general down to an unusually low figure, and have kept reserve banks, like others, from earning more than a very moderate percentage of return. In the case of one reserve bank a 6 per cent dividend has been earned, while others have varied considerably in the amount of the profits they show. Some have not fully covered expenses, but all are now represented as being in a fair way to write off their organization expenses and to put aside a contribution to dividends during the coming year. That the operations of this coming year are likely to result in a more severe strain

upon the resources of the reserve banks is plainly although conservatively predicted by the Board. As to foreign borrowing the Board disclaims all responsibility whatever, declaring that the federal reserve act merely states the conditions under which loans are to be made, from a commercial standpoint, and lays down no principles for the control of the destination or purposes of the loans except in so far as any determination of their commercial character may incidentally do so.

While all has moved smoothly and satisfactorily in the banking world during the past year, the Board nevertheless expresses severe criticism of the conduct of those state banks which have refused to affiliate themselves with the federal reserve system, but which have notwithstanding taken advantage of reductions in reserve requirements made by state legislatures in the belief that such action tended to place their own state banks upon a footing of greater equality with national institutions. Although a few minor amendments to the federal reserve act are asked for, the Board expresses its general satisfaction with the operation of the principal provisions of the act and makes no suggestions that would lead to any drastic alterations.

The reports of the several chairmen, or federal reserve agents, on behalf of their respective federal reserve banks, differ considerably in scope and substance, according to the outlook of the writers. Some of them are purely routine accounts of the business transacted by the banks, written largely from the standpoint of internal administration; others constitute valuable surveys of banking conditions in general. Two or three contain discussions of banking problems and financial prospects in the United States as a whole that are of exceptional value. It is not possible to summarize in brief form the contents of these reports, dealing as they do with a variety of details which can be only very generally indicated for the whole country. Looked at from this latter or general standpoint, however, the reports show a very substantial progress on the part of the federal reserve system in accommodating itself to banking needs and in making itself an integral part of the banking system of the country. The amount of rediscounts, although not large in the aggregate, is shown to have been a very large percentage of the total amount of rediscounting heretofore performed for national banks by national banks—the basis of comparison to which the federal reserve system must, of course, submit, inasmuch as the system is confined primarily to national bank members in its dealings.

In the three southern districts—Richmond, Atlanta, and Dallas—it is made evident that the reserve banks have been of the utmost imme-

diate value to the community, not only relieving the member banks but also aiding in bringing about reductions of interest and improved conditions of borrowing by the public. Elsewhere, owing to the prevailing plethora of money, the reserve banks have sustained themselves largely by open-market operations in bonds, warrants, bankers' acceptances, and the like; but, thus far, have engaged only to a negligible extent in the purchase of ordinary trade acceptances or bills of exchange. Foreign-exchange operations have been engaged in by none, and the clearance and collection system is still experimental and rudimentary. From the standpoint of expense of operation it is shown that the aggregate outlays from the beginning of the system to the close of 1915 were about $2,334,842, while incomes were about $2,193,755. Current expenses were $1,677,639, so that there has been practically a surplus of $500,000 over and above operating outlays.

The statistical appendices of the report furnish complete data regarding the salaries paid by the Board to its officers and employees, as well as concerning the salaries paid by each bank, the earnings and incomes of each of the reserve institutions, the classification of paper purchased or discounted by them, changes in reserves during the year, and a variety of other matters. Included in the reports of the federal reserve agents are many special tables of statistics which throw light upon the conditions prevailing in the several districts to which they relate. In this connection particular reference may be made to the report for the New York district, in which a very careful analysis is made of international financial relations during the past year and of the banking problems that grow out of them with reference to reserves and kindred matters.